

MINUTES
REGULAR MEETING OF THE BOARD OF LAND COMMISSIONERS
Monday, November 15, 2004, at 9:00 a.m.
State Capitol Building, Room 303

PRESENT: Lt. Governor Karl Ohs, Secretary of State Bob Brown, State Auditor John Morrison, and Attorney General Mike McGrath

VIA TELEPHONE: Superintendent of Public Instruction Linda McCulloch

Motion was made by Mr. Brown to approve the amended minutes of the Board of Land Commissioners' meeting held October 18, 2004. Seconded by Mr. Morrison. Motion carried unanimously.

BUSINESS TO BE CONSIDERED

1104-1 GOLDEN ARCHES TIMBER SALE

The proposed timber sale is located 7 miles northeast of Lincoln, Montana, and proposes to harvest from 390 acres consisting of three harvest units. The volume of the sale is 17,700 tons which will generate approximately \$431,764.34 in revenue. The purpose of the proposed sale is to promote tree regeneration, decrease the susceptibility of remaining trees to insect and disease infestations, increase tree vigor, and to reduce the threat of catastrophic wildfire. Access is across existing roads. Approximately .38 miles of road would be constructed or reconstructed and .55 miles of road would be abandoned or obliterated. Public involvement was solicited through newspaper advertisement and letters were sent to interested parties and special interest groups. Mitigation measures were incorporated into the EA and project design. The department's archaeologist found no historical or cultural sites. No significant environmental impacts will result from this harvest. An additional Forest Improvement Fee of \$7.21/ton will be charged. Mr. Clinch requested approval.

Motion was made by Mr. Morrison to approve the Golden Arches Timber Sale. Seconded by Mr. McGrath. Motion carried unanimously.

1104-2 DISCLAIMER OF INTEREST - KEYS & THOMAS V. STATE OF MONTANA

Mr. Clinch said this comes to us because Wade Keyes and Eileen Thomas have brought a suit to quiet title to lands adjacent to the Yellowstone River. These type of issues come before us and are relatively routine, however, in this case, when the department reviewed the factual allegations within the complaint, we concluded the state does have a claim to a portion of those lands that were referenced in the quiet title action. Consequently, we entertained follow up discussions with Wade and Eileen and ultimately they came to agree with our position. What we have before the Board today is a settlement agreement that outlines the resolution of this dispute as well as deeds and a listing of stipulations that we've agreed to in trying to resolve this issue. Mr. Clinch asked for permission to enter into the settlement agreement and lease and file the enclosed quit claim portion of the lands to resolve this dispute.

Motion was made by Mr. Brown to approve the request from the department. Seconded by Mr. McGrath. Motion carried unanimously.

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1104-3 ADOPTION OF PREFERENCE RIGHTS ADMINISTRATIVE RULES

Mr. Clinch said the department has been involved in rulemaking at the direction of the Board regarding the District Court decision dealing with lease renewal of the state agricultural and grazing leases. We've recently completed four hearings, and have now incorporated the comments received into the proposed rule before the Board today. We request approval from the Board to adopt the proposed rules.

Kevin Chappell, DNRC, said in September the Board granted authority for the department to begin rulemaking to deal with the preference right issue that was struck down by District Court. We recently completed four public hearings, held in Dillon, Glasgow, Great Falls, and Miles City. We had very good turnout for those hearings, there were about 400 – 500 individuals who showed up, asked questions, and submitted comments at each hearing. The comment period for the rules closed November 8, 2004. The department responded to all the comments and those comments and responses are contained in the Notice of Adoption before the Board today. Mr. Chappell said one comment from Greg Petesch, Director, Legal Services, questioned the authority to adopt the preference right that was struck down by the District Court. Our response to that aspect of his question was that it is a limited preference right, it is not an absolute right that was contained in the statute. The rules clearly state that the Board ultimately has the authority to issue leases to whoever they feel is best suited to manage those lands. In that case, we do not feel it is an absolute preference right. The other comment Mr. Petesch made is relative to the statutes being implemented for this particular rule. As you may recall this rule, 36.25.117, ARM, was an existing rule and basically we are proposing to re-adopt that rule with modifications. The statutes that were originally listed as being implemented on this rule were §§77-6-205, 208, and 210, MCA. Section 77-6-205, MCA, is the statute that deals with renewal of leases and was the statute that was struck down by the District Court. Section 77-6-208, MCA, deals with subleasing and the loss of the statutory preference right, and §77-6-201, MCA, deals with lease cancellations for subleasing. After review, the department agrees with Mr. Petesch's comment that it would not be appropriate to list §77-6-208, MCA, as an implementing statute because the statutory preference right is no longer valid. In the final rule we are proposing that the implementing statutes be §§77-6-102, 205, and 210, MCA. We feel those are all appropriate to be listed as the implementing statutes for this rule. Beyond that, we did receive a number of comments and we made a few changes to the proposed rules. The most noted might be that we expanded the discussion on situations where you have a contested hearing between the existing lessee who was granted a right to renew the lease and match bids and a bidder who comes in and bids against the lease or we have a situation where we are going to have a hearing before the director to come to a conclusion on whether there should be any adjustment to the rental rate and who the best lessee is. We added criteria for the types of information that the director can request to try to make a determination on best lessee possible. Those are the major points and differences between the proposed rules in September and what we're bringing back today.

Mr. McGrath said after getting the comments from Mr. Petesch, we took a good look at this. Essentially, his comments that the statute was declared unconstitutional, therefore, you can't adopt rules under that statute. But there are other provisions that Mr. Chappell referred to that give the Board authority to adopt rules, one in particular is very broad authority that gives the Board the ability in the management of state lands to adopt rules to do so. I think that is §77-6-209, MCA, it covers our ability to adopt rules in this situation. So we are not adopting rules under the statute that was declared unconstitutional, rather we are adopting them under general authority that the Board has under the general statutory scheme.

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Mr. Morrison said thank you Mr. Chappell for doing final work on this rule. I think it bears repeating that we're engaging in this rulemaking process to address the issue that Judge Sherlock raised when he looked at the preference right statute, which was the elimination of the Land Board's discretion from the preference right process. This rule clearly places the Land Board and its discretion back in the process in such a way that the issue that concerned Judge Sherlock is resolved. And I believe that it does it in a way that is consistent with both preserving the preference right and complying with his decision. So I think the rule is on the mark and does what needs to be done.

Steve Pilcher, Exec. Vice President Montana Stockgrower's Association, said let me begin by expressing my appreciation on behalf of 9,000 ranchers and farmers who are dependent upon these leases for agricultural purposes, and I want to express our appreciation for the timeliness with which the Land Board has addressed this issue. It is a very serious issue, as you've no doubt detected from the people who have taken the time to show up at both the September meeting and the meeting today. I also want to commend the department for their efforts to get out in Montana and take this issue to the country and allow an opportunity for comment. I think the regulated community responded very well, as Mr. Chappell has indicated, between 400 – 500 people showed up at these meetings to learn more about this issue to share their thoughts and opinions. It is critical and I commend the department for their effort to work with the Land Board to address this as they have, and I think you are walking a very fine line here and you've done an incredible job in doing so and we hope you put this issue to rest with your action today.

Motion was made by Mr. McGrath to adopt the amendment of Rule 36.25.117, ARM. Seconded by Mr. Brown. Motion carried unanimously.

1104-4 WHITEFISH PLANNING PROCESS UPDATE

Mr. Clinch said this is a report on the completion of the Whitefish planning process. This Board is familiar with the effort that has been undertaken within the last year with the department trying to develop a plan that would guide the direction of the future management of those 13,000 acres in the Whitefish area. It was this Board that ultimately directed the department and appointed a stakeholder's group that we've worked with for some time and brought that process to fruition. Today is the culmination where we would like to present to you the final plan, talk about the process, and request approval of that plan so we can go forward and submit it to the local authorities.

Bob Sandman, Manager Stillwater Unit, DNRC, said it is my pleasure to be here before you today to present the culmination of about two year's work in the Whitefish community. Based on lots of development pressure and increasing land values in Whitefish, we started to feel some of that pressure for management of state property. In 2003, we decided one of the best ways to address that might be to embark upon the development of a Neighborhood Plan. In other words, try to integrate our operations with local government and the community. We took about 13,000 acres that surround Whitefish and embarked on that effort in March 2003. And that's the first time DNRC has done that with that magnitude. We had three key objectives at that time. The first one was to increase education in the local community about state trust lands. I think we've successfully accomplished that objective. The second objective we had was to try to match up the entitlements for state property with the private property that adjoins those properties. I stand before you today to tell you that I think we've accomplished that in this plan. The third one was to establish some decision criteria to help us make decisions about the management of that property. I think the community has worked extremely hard to identify some

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decision criteria that they think improves the value of the property and yet allows us to continue to generate and maximize revenue for the trust. It has been a very interesting process. Here today is Alan Elm is the citizen's advisory chairperson and he is going to describe the process we went through. The main emphasis in this plan for generation of revenue is to take roughly 10% of the property and leverage that property through some form of development for increased revenue; take the other 90% from the leveraging and through either the purchase of development rights or conservation measures, compensate the trust to maintain that property primarily with traditional uses, which is mostly forestry, and utilize that property additionally for open space and recreational use. This is rather innovative and for us to fully implement this plan, will probably require some additional legislation. But we look forward to that occurring so we can implement the plan. I want to thank a few folks, and then I'll turn it over to Alan. I want the Board members to know that their staff has worked extremely hard on this issue. Without your staff it would have been very difficult for us to accomplish this, so please from me pass on my thanks to your staff for their effort. Second, there has been some DNRC staff, Lisa Horowitz and Steve Lorch, who worked hard with the community to get this thing accomplished. And last but not least is the community themselves. I can't tell you how many hours and how much of their own money this community has put in to this plan for the betterment of state lands. That is a credit to the City of Whitefish and it's a credit to the State of Montana. They should be applauded for their efforts.

Alan Elm, Chair Trust Lands Advisory Committee, said I'd like to thank the Board for establishing the committee and setting up the relationship between the DNRC and the community. As Mr. Sandman mentioned, it has been an educational process for all of us. While there were numerous bumps in the road, it was very exciting for us to be able to stand before the Board today with a plan that the community is very much bought into. With me on the advisory committee was Jeff Gilman, Marshall Friedman, and Diane Conradi. One of the real benefits to this whole process we engaged in was when we started out the Whitefish community at large really didn't have a clue as to the mandates for the state trust lands, and they were viewed as an extension of Forest Service lands or wilderness areas that the community thought was their own personal playground, and it was never going to be subject to a change in usage. Throughout this process one of the things we've accomplished is to educate the community at large as to the existence of this mandate. While there has been some resistance and some divergent opinions I think most of the people have bought into the notion that these lands actually do have to generate revenue for the beneficiaries and they are excited about the compromises we've come up with in our plan. Very much the goal of our plan was to enhance the values and return derived from the property for the trust and at the same time retain as much of these lands as possible for Whitefish users of those lands for traditional purposes. It was very much a collaborative process and we're really indebted to the DNRC staff that worked on this process because in our opinion they really bent over backwards to meet the community and come up with a plan that will work for everybody. Thanks to the Board for initiating this process. We respectfully request the Board approve the plan.

Mr. McGrath said Mr. Sandman mentioned the plan suggests that there would have to be legislation particularly to deal with conservation easements, statutes, things like that. Is the department going to have bills drafted in that regard, or is the community going to follow up on that? How is that going to be addressed?

Mr. Schultz, DNRC, said we do have proposed legislation to sell development rights on trust lands which would preclude the ability to sell rights for grazing, timber, minerals, water, etc. It was taken by the EQC subcommittee six weeks ago. Right now our ability to do conservation in legislation is very limited. We can sell conservation easements to FWP on lands that are within a wildlife management area prior to 2000, so our ability to achieve a lot of the objectives of this plan right now and secure that for long term

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interest to purchase those rights is limited. So we are proposing to sell development rights in a vein that they would be protected. We are carrying some of that forward.

Mr. McGrath said does that have an LC number?

Mr. Schultz replied it does not yet. Larry Mitchell is the drafter and we are still working through that process, but it will have one shortly. We will let you know as soon as we know what it is.

Mr. McGrath said there is also a need to address the conservation easement statute system. Is the department looking at that or is that somebody else's decision?

Mr. Schultz said we felt strategically, not knowing how the election was going to play out, that the term conservation easements, for good or for bad, is a lightning rod before the Legislature. So we didn't want to bite off that chunk, we were trying to achieve a similar objective by selling development rights to basically preserve those traditional uses. So we are not proposing legislation to go in there and push conservation easement language in statute. We are looking at selling of development rights.

Mr. McGrath said technically this Board doesn't have authority to adopt a plan that has any kind of regulatory effect in Flathead County. If we approve this, essentially what we're being asked to do is to recognize the work that was done by the department and by the local community and recommend that it be put in the growth policy. Is that what we're really being asked to do?

Mr. Schultz said in statute the Land Board, and obviously in the constitution, has clear authority over these lands we are taking the tact that we want to be responsible to local needs and want to work with the local communities and we will continue to do that. But ultimately even in statute the Board has authority above and beyond that process to dictate how these lands can be managed. So in terms of approval, we fully agree that we want to go through the local process with the city and county. The question of should the Board approve or recommend support for the plan, I think my preference would be to suggest the Board approve the plan, recognize that we still want to go through those local processes, and if significant changes are made (it's not uncommon that when a plan goes through the city-county process that those local planners may make changes to it) I would think the Board would want to see the final product and endorse it again at some point. Its like when we do preliminary approval for a land exchange. We come to the Board initially with a proposal, the Board approves it to move into the next phase of the process. So I like the language "approve," realizing that the city and county are going to go through their own process but ultimately the Board is going to be the over-arching approving authority for this at least from the state lands perspective, not to say the local authority won't have authority also.

Mr. McGrath said the department is going to come to this Board in the near future with a Draft Programmatic EIS. I assume that if we approve this as you request, then the proposal on the PEIS will not be inconsistent with what is going to be in this file.

Mr. Schultz said no, the fundamental premise of the programmatic plan is we want to continue to bring entitlements to state land and the best way to do that is by engaging local communities and going through that local subdivision planning process. So we would continue to do it. Not that we necessarily will have a process like we had in Whitefish. Like most documents and things we do, it is gauged on the amount of public interest and desire for participation. There are other parts of the state in which you would not see this level of community participation. But when the desire is there we need to react to that desire and be

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proactive and work with the community. This would be consistent with the policies and ideas of the programmatic plan that we've done in the Whitefish area.

Mr. Morrison said it is my understanding that this is kind of a statement of intention on our part. Ultimately the decisions about state lands are decisions to be made by the State Land Board. We're not ceding any jurisdiction over these lands to local planning authorities. When we submit this to them we recognize that our statement of intention may have impacts on their overall master plans. And so we invite them to offer their perspective and take it into consideration and whatever amendments they have to make in their master plan. By the same token, when there are specific transactions to be made pursuant to this plan, those transactions will come back before this Board for approval. And that is when the actual decision will be made about whether a given transaction satisfies the discretion of this Board.

Mr. Schultz said I would agree with that. This document is a learning experience. We've started to hire planners on staff. I look at this as a programmatic plan, there are not site-specific decisions being made. Those actions, whatever they are, would come back to the Land Board for approval.

Frank Gilmore, Chancellor of Montana Tech, said Montana Tech is one of the beneficiaries of the land you hold in the Whitefish area. My first request would be that in the future should you charter such committees as this one, that you require that there be representation by the beneficiaries. You made provisions for that in this charter but the Whitefish committee refused representation from the Montana University System, which is one of the primary beneficiaries of the lands you hold. I have no specific objections to the plan itself, my concerns are with the provisions for compensation to the trust. Specifically, the plan wants to satisfy parts of the trust lands as being forest lands for at least 10, perhaps longer, years. These are prime lands and I do not feel that the best and highest use could ever be considered to be forest lands. I am in the forestry business in another state and I know something about it and I would never put land of this value into forest land. If the citizens of this area wish to have those kept as forest lands or as open space, then they need to make provisions to lease those properties at full market value as the Supreme Court has said with regard to cabinsites or other recreational property. My requests would be (1) that in the future committees of this type be required to have representation from the beneficiaries; and (2) that the timelines in here for decisions with regard to leasing or not leasing these lands be moved to much shorter, something like two to three years.

Daniel Berube, Chair Montana Tech Local Executive Board, said Local Executive Boards are groups of local citizens set up by statute to help represent the interests of the units of the University System in the communities where they are located. Montana Tech, as well as other units of the University System, is the beneficiary of a significant amount of school trust lands in the Whitefish area that appear to fall within the boundaries of the Whitefish school trust lands neighborhood planning document. This document is important in its own right and also is a precedent for other communities seeking to exert influence over the manner in which school trust land are used. We are concerned that the document submitted to the Land Board is inconsistent between its acknowledgement of the obligation to obtain maximum benefits from school lands for the trust and this proposal to seek permanent deed restrictions or conservation easements on more than 90% of the land in order to preserve recreational and open space uses. It is questionable that wholesale permanent restrictions for recreational purposes could be relied on to maximize benefits for the trust beneficiaries. The plan, in various places, asserts that benefits will come from secondary effects such as increased property taxes on private land whose value is increased by permanent restrictions on adjacent school land. Such secondary effects seem to be legally inadequate compensation as is made clear in the plan's discussion of trustee's obligations on page 53. We ask the Board of Land Commissioners to decline endorsing mass permanent restrictions and instead support a

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concept that places more emphasis on the use of leases that are paid annually based on a frequently updated appraised value. This kind of procedure is far more likely to obtain the maximum benefits for the trust lands and its beneficiaries.

Roger Bergmeier, MonTRUST, said I want to commend the effort of DNRC and the people in Whitefish and their planning group to come up with the plan that they have. I think it is commendable in the effort to try and capture some of the increase in value on those 13,000 acres without relinquishing overall control of the lands. I have made several specific comments to the plan which I've sent to the Whitefish Chamber of Commerce, and hopefully they will be submitted as part of the changes. But I have four comments to make to the Board. Recently returns on assets of the trust show that the increase in land values are higher than any other use and locking up trust lands in a long term conservation easement, which at this time is legally questionable, would hamstring efforts to capture some of the increase in value. Secondly, the Whitefish area trust lands have been used without compensation for years. In the Duffield study ten years ago he evaluated the recreational use of trust lands at approximately \$25 per year for a permit for in-state users and \$50 for out-of-state users. It looks like there is a tremendous amount of income that should have gone to the trust and the beneficiaries that hasn't been collected in the past. We could also be considering exchange of these high value lands to help block up land in other areas. For example, it might be possible to exchange land with Plum Creek or Stoltze Land and Lumber Company to block up land in the Stillwater State Forest or the Swan River State Forest to provide a more longer term higher use in some other areas. And lastly, the sale of some of these lands because of their high value could be placed in land banking for purchase of lands in other areas. I think there are many legal questions that need to be answered before we can get involved in this process. This is one of the important notches to Whitefish and other communities in the state. In Missoula the people voted a \$2 million bond issue to purchase open space. These are some things the City of Whitefish may want to consider. I think this plan should not be adopted until such time as these legal questions can be answered.

Mr. McGrath moved adoption of the Whitefish Area Neighborhood Plan, recognizing the extensive work that has been done by the local community and the state in recognizing the importance of this land and value in the future. Seconded by Mr. Morrison.

Alan Elm, Whitefish, said I wanted to respond to the comments of Mr. Bergmeier. The plan very much anticipates getting full market value for any conservation uses that is implemented within the plan. If there is conservation easements or development rights that are taken away from these lands the plan anticipates the beneficiaries being compensated at full market value. I am not sure if they were aware of that aspect of the plan. There is no "taking" involved in the plan.

Mr. Morrison said I want to thank the people of Whitefish who I know have spent an enormous amount of time and their personal money getting to this point helping to develop this plan. It's enormously important not just because Whitefish and the area around it is a treasure for the whole State of Montana and needs to be managed very carefully, but you have really set a precedent for the collaborative process of developing state land management strategy for the State of Montana. As we are increasingly looking at lands that are in the urban interface the lands that growing cities are encroaching into that have historically been used for grazing, timber, and other traditional uses. This kind of collaborative approach has created a successful model which I can only hope will be a success in future instances as this has been. I also want to say that in this process, as in the preference right issue we just dealt with, this Board has shown its intention to take stewardship issues and long term planning issues seriously as we develop state land management strategy. And while ten years may seem like a long time to some, we all know that that land is going to be there and the impacts of what is done here are going to last for many

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many decades and perhaps hundreds of years. So we are doing the responsible thing here to make sure these lands are managed and eventually developed or not developed in a way that is in the best interest of the people of Montana.

A vote was taken on the motion. The Board gave unanimous approval to the Whitefish Area Neighborhood Plan.

1104-5 REQUEST FOR APPROVAL OF RIGHTS-OF-WAY APPLICATIONS

This month there are nine applications for rights-of-way. Number 12406, 12407, 12408, 12409, and 12739 are from NorthWestern Energy for telecommunications cables; #12740 is from Owl Corporation for buried sewer and water lines; #12741 is from Flathead County for a public road; #12742 is a reciprocal easement exchange between Plum Creek Timberlands and the State of Montana; and #12743 is from the Nature Conservancy for a perpetual non-exclusive easement for constructing, reconstructing, maintaining, repairing and using a road. Mr. Clinch requested approval of the entire rights-of-way package.

Motion was made by Mr. Morrison to approve the application package. Seconded by Mr. Brown. Motion carried unanimously.

1104-6 FY-04 YEAR IN REVIEW

Mr. Clinch said the department would like to present a power point presentation about the FY-04 year in review. This is a culmination of the department's activities as well as many of the actions that have come before this Board in the past that fulfill our fiduciary responsibilities and ultimately consummate the large contribution to the trust beneficiaries that occurs annually. Also as part of this, we intended to present the two 2004 revenue checks to Superintendent Linda McCulloch, but in her absence, we are going to postpone that to a more appropriate time. I think probably Ms. McCulloch will take a great deal of joy because in addition to getting the regular "brick in the toilet" check, this year we're also going to be submitting a substantial check from the timber sale programs, that's the Technology Acquisition Fund. We look forward to doing that with Superintendent McCulloch at your convenience.

Tom Schultz, Administrator Trust Land Management Division, presented a power point show of the accomplishments by the department during FY-04. Mr. Schultz said this is one of the most fun things I get to do. It is not a reflection of anything I have done but of what the folks in the field have done. You heard Mr. Sandman talk earlier about the work that was done by our folks and we don't get an opportunity much to toot their horns so we do want to do that today. There is a tremendous amount of work that has gone on and we that we want to touch on. The amount of work we've accomplished this last year is phenomenal and we try to do things in a prudent way. We look at ourselves as good stewards first and foremost and we also look at ourselves as asset managers. You'll hear that term more and more as we look at things. My vision of where we are going is land allocation. If you look at how our lands are currently positioned, we are an ag and grazing organization. You may not necessarily know that or get that feel by a lot of the discussions we, have but look at our land base and where the revenue comes from, its actually ag and grazing and minerals for the most part. Yet a lot of our focus is on real estate, forestry, and other things. Eighty percent of our lands are grazing lands, another 12% of our lands are agriculture or cropland acres, and we have about 9% that is timber, and less than 1% is classified "other."

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Classified “other” could be recreational use, commercial leasing, or cabinsites. So my vision of the future is to flip flop things and divest some of the isolated grazing land. I know we talked about doing it in land banking by increasing our holdings in irrigated cropland and increasing some of our real estate opportunities also. We are still looking at less than 1% in the short term and ideally between conservation and real estate and long term, I would like to see 2% of land base being classified “other” while also increasing our timber base. That’s my introduction. This presentation is about the people who have done the job. We’ve got about 126 trust land employees across the landscape that have put in numerous hours in all the programs and not only do they work in the Trust Lands Management Division but they also work feverishly putting out fires during the summer time and training other times of the year.

Overview and history: The Enabling Act and the Montana Constitution first and foremost granted lands to the state to basically support common schools and other educational endowments. The State of Montana came into the Union in 1889. There were other states that came in at the same time, the States of Washington, North Dakota, and South Dakota. When there are questions as to how we do things, we look at the other states and see how they do business. Mr. Chappell presented the ag and grazing rules today and a lot of those rules criteria came from the State of Arizona and what they are doing. So we can look to other states, particular ones that have the same Enabling Act, to get some ideas on how to do business. As stated in the Montana Constitution, these are public lands and you’ll hear the department referring to trust lands. We have this constant tug between public lands as defined in the Constitution and trust duties that are predominantly spelled out in common law through court cases. It is clear that these are trust lands but also the Constitution, and elsewhere in statute, talks about public lands of the state. So we find ourselves in a unique position of how they are viewed by the public, and viewed by all of us with fiduciary responsibilities. We take what we do very seriously. The mission we have [*Manage the State Trust Lands to produce revenues for the trust beneficiaries, while considering environmental factors and protecting future income-generating capacity of the land*] is a good summation of how we balance our stewardship responsibilities and our fiduciary responsibilities. We take a look at the short and long term and try to make sure we are generating revenue now as well as having the long term productivity of the trust, maintaining the productivity of the land.

We have been engaging with folks from Montana Tech and the Montana University System on issues regarding funding and how they perceive how much money we charge, so I do expect them to be more of a player over time in how we manage lands. We manage about 5.2 million acres, the bulk of those acres, about 90%, are common school acres and the rest of the trusts make up the 9-10%. We had the biggest year ever in terms of revenue this year. We’ve done a better job in terms of reporting and the annual report should be out within the next two weeks. But we had a net of about \$50.7 million for common schools this year. The average state share per pupil is about \$3,700. If you look at the amount of money we generate for schools, in 2004 we generated approximately \$50.7 million, which was about 9.2% of the state’s share of public school funding, our share was \$340 per pupil. One thing we haven’t talked much about a lot in the past but is something to take note of is the Technology Acquisition Fund. There is a statute regarding timber sale revenue and volume that is generated. Timber sale volume that we harvest in excess of 18 MMbf goes into the Technology Acquisition Fund. That money is not appropriated by the legislature, it is a statutory appropriation. This past year OPI received a little under \$3.2 million for the requirements set out in that statute for funding, buying computers and those kinds of things. That was above and beyond the \$50.7 million mentioned as the net revenue.

Mr. Morrison asked how does that compare with the last few years?

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Mr. Schultz said it really has fluctuated. Last year was suspended. We had a special session that suspended that legislation, so last year there wasn't a Technology Fund contribution. The previous year it was a little over \$100,000 and in years past its been anywhere from \$250,000 to \$2 million. This, again, is the biggest year we've had for the Technology Acquisition Fund. As we go into the future with the increased harvest levels on state land, that number should continue to go up because it is volume in excess of 18 MMbf.

Mr. Brown said do you know to what extent that has been used, the \$3 million for Technology Acquisition? It seems like it's a big windfall that the school districts might not plan for.

Mr. Schultz said no.

Kathy Bramer, OPI, said I don't know specifically if the school districts have used it. It is distributed on a per pupil allocation basis so I think for the most part they have received it and I am sure they generally have put it to good use. I can report back to you, we get reports from them. It was allocated.

Mr. Schultz continued with his presentation.

Asset Managers: Mr. Schultz said I have talked about us being asset managers. The land value that is out there is significant. We have about \$420 million in the permanent fund. If you look at the land value we're talking about \$3.6 billion. When you look at the Constitution, what makes up the permanent fund is not just the cash in the bank, but land is a part of the permanent fund, so when we talk about the corpus of the trust or the body of the trust, the land value dwarfs the cash we've actually generated for the permanent fund. This number last year was about \$3.4 billion so its going to fluctuate over time. But we expect this asset value to climb into the future as land values appreciate.

Organization: We have a direct reporting responsibility to the director but at the same time we also serve the Land Board in this capacity. We have delegated statutory responsibility to manage state lands. We have four bureaus, we have field operations, and we have six major area offices throughout the state in Kalispell, Missoula, Helena, Billings, Miles City, and Lewistown. So we do have folks positioned throughout the state to accomplish all these duties.

Agriculture and Grazing: We have about 4.6 million surface acres currently under lease, the bulk of those are under grazing. There are about 550,000 acres that are cropland. We have about 10,000 leases. Grazing revenues are about \$5.5 million, with 1.1 million AUMs. There are actually more AUMs on state land then there are people in the State of Montana. Agricultural revenues are \$8.4 million and about 1/3 are from farm program payments. With about 12% of our land base currently in agricultural production we generate about \$15 per acre from ag land and about \$1.25 from grazing land. The farm program payments are a big contribution to what we can generate for CRP payments and other things. Ultimately we're trying to move toward acquiring more of that agricultural land base. Our minimum lease rate on state lands right now is \$5.50 per AUM.

Forestry: We had a banner year in forest management this past year. The revenues in FY-04 reflect both forest improvement collections which were about \$2 million as well as gross timber sale receipts. The Board last year approved 50.8 MMbf for sale, and if you remember HB 537 talked about a target of 50 million, we met that target. The timber volume sold was about \$50.1 million; volume harvested was 46 million. Keep in mind the harvested volume in a timber sale contract can last between three and five years. Our average timber sale is harvested about a year and a half so there is not a direct correlation

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between sold volume and harvested volume. Harvested volume fluctuates somewhere between 35 million and 45 million. So in terms of harvested volume last year we had a pretty good year. We also cited the Sustainable Yield Study and we've also been working diligently in completing conservation strategies for the Habitat Conservation Plan (HCP). We expect to have the draft HCP available in August 2005, we'll have draft strategies completed which will have public review and Land Board information items. The price of lumber for a consumer doesn't look good right now, but as a timber salesman it looks great. It is a great time to sell. The price of wholesale lumber right now is \$4.25 for 1000 board-feet, yet stumpage prices typically parallel that. Last year our average sale price was about \$160 per 1000 board-feet, this current year we are up to over \$200 per 1000 board-feet.

Mr. Morrison asked to what extent do you take those variations in the market into consideration in the management of the sales?

Mr. Schultz replied we've had that question before and the term I used is dollar cost averaging. In the timber sale program if we had the opportunity to play the market it sounds great but we just don't have 50 timber sales sitting there that we've completed ready to go that we can hold off or sell. So we typically don't play the market. We do have a few options, we can look at when the prices peak and when they fall. It seems we get better prices in the spring than we do later in the year. But the tough thing is folks in field have just gotten through fire season and they're working on timber sales during the winter time, it would be nice to have a lot of sales to sell in the spring but if you look at our historic number of sales, we sell a lot of timber sales in May and June right before the end of the fiscal year. So it is kind of a workload issue. Ideally, we should be selling more sales in the fall and the spring and less probably in late spring or early summer, but it doesn't always happen that way. The short answer is we don't do a good job of playing the markets but we are aware of trends and if we could do better we'd love to.

Internal BMP Audits: This isn't just about generating revenue, which is a big piece of what we do, its about stewardship. A lot of the stewardship we do through auditing, whether it is ag and grazing lease evaluations, BMP audits, or other monitoring for the forest plan, those kinds of things. We do about 30-40 internal BMP audits per year on our timber sales. In this period of time we performed 43, and we also had statewide audits that aren't rolled into the numbers that the Forestry Division does. They look at timber sales across the state and at state, federal, and private lands in that function. We have evaluated over 100 miles of road, almost 3700 acres of harvest representing about 15 MMbf of that. Ninety-eight percent of all practices rated have exceeded BMPs, only 2% of practices had minor departures, and we had only four major departures out of 1461 practices. Not that I like to count the bad stuff, but we need to be honest with ourselves and improve. On the major departures I asked David Groeschl, DNRC's Forest Management Bureau Chief, what those related to and it has to do with road construction and reconstruction. Roads that were existing roads that we had sediment running off of and from a BMP perspective when you have sediment running off the roads that is a major departure. Like every landowner we try to do the best we can and we look at what we're doing. We employ the best practices but we don't always exceed our expectations but if we do have some problem we follow up and we do need to report that.

Mineral Management: We had a great year for minerals this past year. Last year we were at \$12 million and we had almost a \$4 million increase. The bulk of the mineral production is oil and gas followed by coal and then we have a little bit of other revenue mixed in. The price on average for a barrel of oil is a little over \$30 both nationally and in Montana. Currently in FY-05 what we're looking at is about \$40 per barrel for oil. If you're selling oil and gas high prices are good, if you are a consumer its not so good. Natural gas prices have shown a steady increase over the last couple of years and its going to continue to

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go up, we're at about \$4 per 1,000 cubic feet. Coal prices have taken a dip in the past year, they are slightly below \$10 per ton in Montana.

I wanted to talk a little bit about coalbed methane and since it is a controversial topic for the Board so I thought it would be good to talk about some things, at least the revenue picture. Most of the coalbed methane gas production prior to January 2004 was coming from non-trust lands. Currently, we are at about \$100,000 per month in revenue from about 20 wells that have been approved by the Board. We have about 840 acres in production generating about \$100,000 per month in revenue, so over the course of a year you're looking at about \$1 million from 20 wells. Here are the three plans of development, Badger Hills has the 20 wells I spoke about and that the Board has approved; the Dry Creek has 11 wells, the Board approved this one so we expect this to come on line; and the final one is the Coal Creek plan which has not come to the Board yet, it will be coming within the next couple of months, it has 16 wells on state land. These are all located within the CX Field in Bighorn County. There has not been any movement outside of that county or the existing field.

Otter Creek: We have been bombarded with interest from folks on the Otter Creek tracts. There was legislation passed, SB 409, which gave the department authorization to spend up to \$300,000 collecting data to make these tracts more leasable. Typically when we develop coal or oil and gas we wait for someone to come to the department to nominate a sale. There has been interest from an economic development perspective to get something going in the Otter Creek area. So we have gone out per statutory requirement and completed the initial cultural survey as well as collecting coal log and core sampling data. We haven't had a chance yet to evaluate the data, but we do have that data now. We have a contract with Kennecott which is a major coal player, they went out to collect the data and we are going to be evaluating that data for quality of coal and quantity of the coal. And if that information coupled with the cultural data suggests that it might be a good thing to do, you might see under the direction of somebody, the leasing of that. We would still prefer to have somebody come to us to make application, if that doesn't happen, and depending upon how much interest there is, the state may move forward under the direction of the Board, if it so desires, to put out for lease some of these tracts. There are some potential markets. The big "if" is if the Tongue River Railroad is built. You've heard a lot of rumblings about the Tongue River Railroad and the opportunity for that to come in or if there could be a coal-fired power plant in the local area there. There needs to be some major capital investments, I think we're talking over \$1 billion in investments put in to make this coal marketable, whether it is marketable locally or outside of the state. We will make that data available shortly.

Real Estate: We had significant increases in revenues this year. Last year our revenues in real estate were about \$2 million, FY-04 revenues are \$4,531,103. What are the growth opportunities on these trust lands? There are issues of coalbed methane, issues of Otter Creek, I think the timber sale program is going to be pretty consistent and constant, our biggest opportunities for growth in the short and the long term are real estate opportunities. Rights-of-way was \$2 million. If you recall the Board approved the Conservation Easement to FWP for \$1.6 million, that was a big boost, but a one time shot in the arm. Land sales are a small piece. The residential leases are our cabinsites leases that are a big money maker for us. Recreational use is big, \$914,000. The Board approved the concept of moving ahead with an agreement with FWP for \$2.00 per person for access and we are generating a lot more revenue under the current agreement with FWP. Everybody who buys a conservation license pays \$2.00 for access to state lands. We have had some feedback on that, there is a question about equity between those who are hunting and those who are recreating in a non-hunting capacity. A non-hunting recreational use license is \$10, so you pay \$2.00 to hunt on state land and \$10.00 if you want to go hiking. The statute directs the \$2.00, the rule directs the \$10.00. We need to figure out what we're going to do if we are going to

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modify the \$10.00 recreational use license for other uses. We know there are constituencies out there that will fight that, there are also constituencies that will fight the status quo so our plan was to at least let a year go by, collect the revenue, collect comments, and see what decision we want to make in the future.

Spring Prairie Center: This is located in Kalispell. The Board approved the lease agreement in 2003, Goldberg Properties was looking to build on the entire 60 acres in three phases. Lowe's is the first store up. We have also negotiated an agreement with Costco, and it will be relocating on the state tract too. When this tract is fully built out on that 60 acres, there is a 640-acre tract there, this 60 acres is anticipated to generate in excess of \$500,000 per year when all three phases go in. The high school they are looking to put in there was approved by the local community through a bond recently, and we are due about \$600,000 for an easement for the high school. That tract, when we look at where lands are positioned, where it is appropriate to do development and those are the things we are looking to do which are appropriate with this community support.

Mr. McGrath said would you give us a figure of what you expect to gain from that 60-acre tract?

Mr. Schultz said when all three phases are completed, we're expecting about \$500,000 per year in annual rentals. From the 16 acres of the first phase, we are expecting about \$115,000 to \$120,000. They are also looking at potential movie theaters.

Lewis & Clark Subdivision: This is located in Bozeman, and has been a success for us and we're hoping to have more opportunities. In the state building there we have the Department of Revenue, DNRC, and the Department of Agriculture. There is a 28-acre eight lot subdivision on the interstate. We worked in a joint venture capacity with the developer to bring that state building to fruition. The Department of Revenue built the building. These are opportunities where we can do things to significantly increase the revenue production to the schools and also meet the needs of the state as it continues to grow. The building was occupied in May 2004. Currently, we're looking to lease the other lots, there has been some interest, but nothing has come to fruition yet.

Wind Energy: This is another big opportunity on state lands. Montana has enormous wind potential that still remains untapped. The Land Board approved a lease agreement with Wind Park Solutions America at the September 2004 meeting. The lease is for 640 acres and the footprint of the wind towers is less than one acre, there will be 20 towers. So from 20 acres of 640 acres we are going to see rentals of about \$75,000 per year. We have significant opportunities depending upon where the land is situated for these kinds of other opportunities. From an economic development standpoint there is tremendous opportunity for growth on state lands that actually complement the desires of the local community and will significantly increase returns to the trust.

Finally, the things I talked about today couldn't be done without our hard working staff. Becky Shephard (Lewistown) and Barb Powell (Missoula) received the Support Staff of the Year award; Brian Robbins (Anaconda) received Forester of the Year; David Greer (Kalispell) received the Land Use Specialist of the Year award; and Julie David (Helena) and Bob Storer (Missoula) both received the Division Administrator Award. We are going to present the revenue check next month and hopefully those folks will be there to help present it.

Motion was made by Mr. Brown to adjourn. Seconded simultaneously by Mr. Morrison and Mr. McGrath.